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November 23, 2008

Ms. Anne Stausboll  
Interim Chief Investment Officer  
California Public Employees' Retirement System  
400 Q Street  
Sacramento, CA 95814

Re: Revision to Supplemental Income Plans Policy – Short Term Trading

Dear Anne,

You requested Wilshire's opinion with respect to Staff's proposed revisions to the Statement of Investment Policy for Supplemental Income Plans. Specifically, the Policy revisions allow for Staff to limit excessive short term trading by participants in their accounts that may be detrimental to other plan participants.

**Recommendation**

Wilshire recommends that the Policy Subcommittee approve the changes.

**Background**

The Supplemental Income Plans (SIP) investment vehicles allow participants to craft a personalized investment plan to address their retirement income needs. The SIP offers a wide variety of investment options to participants, including domestic and international equities, fixed income, target retirement date funds, and risk-based funds.

As technology has evolved, administration of defined contribution plans has changed to allow participants to affect trades electronically, by fax, or by phone. Participants can also view their accounts online at a moment's notice. However, the increased access to their accounts has spurred some participants to begin trading in their accounts around short-term market movements, rather than investing for the long term. One particular strategy is to arbitrage the expected movements in international stocks, due to the timing of the daily pricing of the commingled funds used in defined contribution plans. International stock funds need to have a share price (NAV) assigned once per day, but the overlap between the European, Asian, and North American markets means that the price cannot be determined when all markets are closed. As a result, participants in the SIP can transact in CalPERS' pooled vehicles at a price that may no longer reflect the market's

actual value. The net effect is that these arbitrage transactions take place at stale prices and the short term traders who profit do so at the expense of the other investors in the funds. This practice is industry wide, rather than CalPERS-specific.

The changes to the policy give Staff the ability to limit the ability of participants to trade using such strategies. Staff can restrict exchange privileges, restrict short term trading, or, in extreme cases, expel a participant from the fund. These practices are broadly accepted within the industry and serve the best interests of the plan's participants.

### **Conclusion**

Wilshire believes that the changes in the Policies are appropriate and will protect the participants in the SIP from having their investments unfairly diluted by short term traders. We recommend that the Policy Subcommittee approve the changes to the Policy.

Should you require anything further or have any questions, please do not hesitate to contact us.

Best regards,

A handwritten signature in black ink, appearing to read "Ann J. Smith". The signature is fluid and cursive, with the first name "Ann" and last name "Smith" clearly distinguishable.